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FISCAL IMPACT STATEMENT

LS 7571 **NOTE PREPARED:** Feb 18, 2003
BILL NUMBER: SB 1 **BILL AMENDED:** Feb 18, 2003

SUBJECT: Economic Development.

FIRST AUTHOR: Sen. Ford **BILL STATUS:** CR Adopted - 1st House
FIRST SPONSOR:

FUNDS AFFECTED: X GENERAL **IMPACT:** State
X DEDICATED
FEDERAL

Summary of Legislation: (Amended) The bill exempts purchases of equipment for research and development from Gross Retail and Use Taxes. The bill increases the Research Expense Credit to 20% of research expenses and makes the credit permanent. The bill establishes a 15% Technology Commercialization Tax Credit against state tax liability for expenses incurred to commercialize technology developed in Indiana.

Effective Date: July 1, 2003.

Explanation of State Expenditures: (Revised) *Indiana Department of Commerce (IDOC)*: The Technology Commercialization Cost Tax Credit established by the bill would create additional administrative demands for the IDOC. The IDOC is responsible for determining eligibility of taxpayers for the Commercialization Cost Tax Credit. For this tax credit the IDOC must make determinations relating to (1) the type of investment in commercialization costs and (2) that commercialization costs equal at least $250,000 in the first year and $2 M over the four years of the tax credit. The February 7, 2002 state staffing table indicates that the IDOC has 43 vacant full-time positions, including regional office positions.

Department of State Revenue (DOR): The DOR would incur some administrative expenses relating to the revision of tax forms, instructions, and computer programs to incorporate the tax credits established under this bill. Under claw back provisions of the bill, the DOR also would have to oversee both disallowing credit claims and seeking repayment of credit amounts by taxpayers who fail to remain eligible for the Commercialization Cost Tax Credit. These expenses presumably could be absorbed given the DOR's existing budget and resources.

<u>Explanation of State Revenues:</u> (Revised) *R & D Sales Tax Exemption:* This bill exempts purchases of tangible personal property for direct use in research and development. Based on adjusted data from the National Science Foundation, it is estimated that exempting these purchases from the Sales Tax could reduce state revenue by $48.4 M in FY 2004 and $54.6 M in FY 2005.

Sales Tax revenue is deposited in the Property Tax Replacement Fund (50%), the state General Fund (49.192%), the Public Mass Transportation Fund (0.635%), the Commuter Rail Service Fund (0.14%), and the Industrial Rail Service Loan Fund (0.033%).

Research Expense Credit: This bill increases the Research Expense Credit from 10% to 20% for tax years beginning January 1, 2004, and makes the credit permanent. It is currently set to expire December 31, 2004. It is estimated that these changes will result in an additional revenue loss of approximately $25 M in FY 2005.

Over the past four years, the current Research Expense Credit has ranged from $9.2 M in FY 1996 to $24.2 M in FY 1999. However P.L. 192-2002ss increased the credit to 10% and eliminated the apportionment formula. Consequently the cost of the base credit was estimated to increase by an additional $47.9 M in FY 2004 and $51.5 M in FY 2005 for a total cost of $72.1 M in FY 2004 and $75.7 M in FY 2005. This bill will potentially increase the total cost of this credit to approximately $100 M in FY 2005. Research Expense Tax Credits affect revenue collections deposited in the General Fund.

It is difficult to estimate the exact impact of continuing this tax credit since it is dependent on both the amount of research expenses individual taxpayers make during the year and their total tax liability. With additional incentives created for research and development activity based in the state of Indiana, the revenue loss from this credit could increase by an indeterminable amount. The credit provides $100,000 for each $1 M in new research expenses. Increased expenditures on research activities could also generate additional Adjusted Gross Income and Sales Tax revenue if these expenses are used to hire additional employees or purchase related equipment.

Technology Commercialization Tax Credit Program: The bill establishes a credit against the Adjusted Gross Income (AGI) Tax, Financial Institutions Tax, or Insurance Premiums Tax liability for qualified technology commercialization costs incurred on or after January 1, 2004. The amount of credits that could potentially be claimed by taxpayers is indeterminable. The net revenue impact depends on the extent that collections from employment or other investment attributable to creditable commercialization activities is less than or exceeds the amount of credits claimed by taxpayers. However, if the commercialization activities would have occurred in the absence of the tax credit, the net impact would be the total credits claimed by taxpayers.

The bill provides for a nonrefundable tax credit for costs relating to investment in machinery and equipment and obtaining rights to use or the use of technology, including fees related to patents, copyrights, and licenses. A taxpayer may receive credits for commercialization costs incurred in four taxable years at one business location. (Taxpayers may qualify for an additional four years of tax credits for costs at the same business location.) The credit amount in any taxable year is equal to 15% of money invested in commercialization costs for one business location. However, the credit amount may not exceed 50% of the taxpayer's tax liability in a taxable year after application of all other tax credits.

The tax credit may be applied to the taxpayer's tax liability or distributed to shareholders, partners, or members if the taxpayer is a pass through entity, over five taxable years beginning in the taxable year after the year in which IDOC certification was obtained. (A pass through entity is an S-Corporation, partnership, trust, limited liability company, or limited liability partnership.) The taxpayer may carry forward any unused credit amount from a taxable year for a maximum of 21 subsequent taxable years. The amount the taxpayer may apply in a taxable year excludes any part of the credit carried forward from a prior taxable year. The taxpayer is not eligible to carry back any unused credit. For pass through entities, the credit may be claimed by shareholders, partners, or members in proportion to their distributive income from the pass through entity. The tax credit is not available in a taxable year in which machinery and equipment is not in regular service in Indiana or for an investment for which another research and development tax credit is applied.

Revenue from the AGI Tax on corporations, the Financial Institutions Tax, and the Insurance Premiums Tax is distributed to the state General Fund. Eighty-six percent of the revenue from the AGI Tax on individuals is deposited in the state General Fund, and 14% of this revenue is deposited in the Property Tax Replacement Fund. Since the credit is effective beginning in tax year 2004, the fiscal impact would begin in FY 2005.

Eligible Taxpayer: Taxpayer eligibility is determined by the Indiana Department of Commerce. Eligible taxpayers must incur commercialization costs for a trade or business the taxpayer conducts. The costs must include the purchase or lease of machinery and equipment placed in and maintained in service in Indiana. The machinery and equipment must be used in relation to technology production or to produce resources essential to technology production. The commercialization costs must be equal to at least $250,000 in the first year of the credit, and $2 M for the four-year duration of the credit. The bill contains claw back provisions for taxpayers that do not meet these monetary investment requirements. The bill also permits a taxpayer certified for credits to sell the credits to another taxpayer for use in that taxable year or future taxable years. The credits must be sold for at least 75% of their value, and the purchaser must apply them in the same manner and against the same taxes as the taxpayer certified for the credits.

Explanation of Local Expenditures:

Explanation of Local Revenues:

State Agencies Affected: Indiana Department of Commerce, Department of State Revenue.

Local Agencies Affected:

Information Sources: Department of State Revenue; National Science Foundation.

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